



## BUSINESS LAW SECTION

THE STATE BAR OF CALIFORNIA

### **LEGISLATIVE PROPOSAL (BLS-2008-07) NONPROFIT DIRECTOR/OFFICER LIABILITY**

**To:** Larry Doyle, State Bar Office of Governmental Affairs

**From:** Lisa A. Runquist, Chair  
Nonprofit & Unincorporated Organizations Committee  
State Bar of California Business Law Section

**Date:** July 26, 2007

**Re:** Proposed Amendments to Corporations Code §§5047.5 and 24001.5

#### **SECTION ACTION AND CONTACTS**

Date of Approval by Legislative Subcommittee of the Section Executive Committee: July 31, 2007

Approval vote: For: 4 Against: 0

Date of Approval by Nonprofit & Unincorporated Organizations Committee: July 16, 2007

Approval Vote: For: 8 Against: 0

#### Executive Committee Contact

Keith Bishop, Esq.  
Vice Chair, Legislation  
Buchalter Nemer, PC  
18400 Von Karman Avenue, Suite 800  
Irvine, CA 92612  
(949) 224-6293  
949-224-6228 FAX  
[kbishop@buchalter.com](mailto:kbishop@buchalter.com)

#### Standing Committee Contact

Lisa A. Runquist  
Chair  
Runquist & Associates  
17554 Community Street  
Northridge, CA 91325  
(818) 760-8986  
(818) 760-8314 FAX  
[lisa@runquist.com](mailto:lisa@runquist.com)

**PURPOSE:** To clarify when statutory limitation of personal liability of volunteer members of Board and Directors and officers of nonprofit organizations is not available and what insurance is required for that limitation to be available.

**DIGEST:** Sections 5047.5 and 24001.5 of the Corporations Code provide a limitation of personal liability for officers and directors of nonprofit corporations and associations. Both

Sections provide that their protections do not extend to a nonprofit entity that “unlawfully restricts membership, services or benefits” on various prescribed bases. Prohibiting unlawful discrimination is entirely proper. However, trying to do so by a blanket denial of limited liability to directors and officers as to all matters, regardless of their culpability for or even awareness of unlawful discrimination, is both unjust and overbroad. The Committee believes that the current statutory scheme is counterproductive because it discourages potential volunteers from donating their time and services as directors and officers. A more fair and measured approach is to deny liability based on the volunteer’s knowledge and intent with respect to unlawful discrimination by the nonprofit corporation or association. This is explained in more detail in “Analysis,” below.

**BACKGROUND:** Corporations Code Sections 5047.5 and 24001.5 were added by Stats. 1992, c. 726 (S.B. 1264, §§ 3 and 4, respectively). For both, the Legislature found and declared that

the services of directors and officers of [the applicable nonprofit entity] who serve without compensation are critical to the efficient conduct and management of the public service and charitable affairs of the people of California. The willingness of volunteers to offer their services has been deterred by a perception that their personal assets are at risk for these activities. The unavailability and unaffordability of appropriate liability insurance makes it difficult for these [nonprofit corporations or associations] to protect the personal assets of their volunteer decisionmakers with adequate insurance. It is the public policy of this state to provide incentive and protection to the individuals who perform these important functions.

That goal remains as important today as it was then. Unfortunately, the provisions for achieving it are, by their own terms, counterproductive and unpredictable. This Proposal is designed to eliminate those problems while ensuring that actions by officers or directors taken in violation of laws against discrimination are not protected by the limitation of liability.

## **ANALYSIS:**

The Committee believes that nonprofit organizations are important contributors to health, safety and general welfare of the public and that the Legislature should encourage their contributions. Many nonprofits do not have fulltime staff and depend entirely upon efforts by volunteers, including volunteer directors, officers, members and/or trustees. Without individuals who are willing to donate their time and efforts, many nonprofits could not operate successfully. At the same time, volunteer supervisors cannot ensure that no one in the organization acts wrongfully, including wrongful acts of discrimination. The Committee believes that the threat of personal liability without personal wrong-doing can be a substantial disincentive to service as a director or officer. This overhanging threat is exacerbated by the potential cost of defense or extended settlement – which can be bankrupting, even when the proceeding ends with exoneration. Accordingly, the Committee believes that the Legislature should change the law so that it preserves the current statutory liability protection for volunteer directors and officers except in those cases involving actual and purposeful misconduct by the individual that results in unlawful discrimination.

### Scope of Discrimination Exclusion from Liability Protection

Sections 5047.5 and 24001.5 of the Corporations Code are meant to limit the liability of volunteer directors and officers of nonprofit corporations and associations who serve without compensation. Unfortunately, the current laws are ambiguous and ineffective. They do not provide volunteer directors, officers, members or trustees with predictability and security regarding the limitations of their liability exposure. Instead, they create unpredictability as to whether a plaintiff in a matter totally unrelated to membership, services or benefits could use potential inapplicability of statutory liability protections by adding allegations of wrongful discrimination by the organization as a weapon. If the discrimination is not ultimately shown to exist or be unlawful, the volunteers should prevail. Nonetheless, even unfounded allegations of discrimination will result in serious costs even at the summary judgment or pretrial discovery level, and these are frequently used to force defendants into unfair settlements. This is a risk and a cost to which volunteers should not be subjected.

Many, if not the majority, of nonprofit corporations and associations are formed for the specific purpose of aiding a defined class of individuals. In that context, they do “discriminate” in favor of these individuals but doing so may be not only lawful but also highly beneficial to and encouraged by society. For example, a children’s hospital is designed to assist sick children. Guide Dogs for the Blind provides exclusive services to a specific group of disabled individuals. Organizations to protect battered women or abused children “discriminate” by devoting their resources to those groups. It cannot be the Legislature’s intention to require volunteer directors, officers, members and/or trustees of such nonprofit entities to spend time and resources to demonstrate that such entity’s criteria for membership, services, and benefits are lawful, particularly if the plaintiff’s claim in the particular case has nothing to do with such criteria.

The state policies and laws regarding antidiscrimination would be fully served if, instead of the blanket approach now taken, nonprofit directors and officers are denied the protection of Corporations Code Sections 5047.5 and 24001.5 *only with respect to a claim based on their knowing and intentional misconduct in unlawful discrimination*. In other words, if a volunteer director, officer, member or trustee knowingly and intentionally engages in conduct causing or intending to cause unlawful discrimination, he or she would not enjoy the protection of Corporations Code Section 5047.5 or 24001.5. But actions taken in unrelated matters should not be denied protection because of broad claims against the entity for the purpose of coercing settlement on those matters.

### Nature of Insurance Coverage

Sections 5047.5(e) and 24001.5(e) of the Corporations Code both require that a “general liability” policy be applicable to the claim. In point of fact, such policies often do not cover employment-related or other claims that are brought against directors and officers. These claims frequently are covered by director’s and officer’s liability policies or employment practices liability policies. Also it is not necessary in many cases that a policy be in effect both at the time of injury and at the time of claim. The key measurement need only be that the policy covers the claim. Our proposal does cover the claim and would make it possible for nonprofit corporations

and associations to assure their directors that this statute provides the type of protection the legislature intended.

**LEGISLATIVE HISTORY:** AB 14 introduced in the 2007 term of the legislature has an impact on those Sections, but the text of the amendments provided in the Proposal has the effect of accounting for such changes if AB 14 is enacted into law. We are not aware of any other legislation introduced on this topic since Sections 5047.1 and 24001.5 were enacted into law but have not made a specific search of legislative records.

**DOCUMENTATION:** We are not aware of any studies, reports or statistics with respect to these statutes.

**HISTORY:** This is the first time that the Committee has presented this Proposal and, to the best knowledge of the Committee, the first time it has been considered by the State Bar or the Legislature.

**PENDING LITIGATION:** We are not aware of any specific pending litigation that would be affected by this Proposal. However, it is possible that litigation is, or will be, pending against directors and officers of nonprofit organizations.

**LIKELY SUPPORT:** We anticipate support from nonprofit corporations and associations organized under the laws of California but have not taken any steps to assess the potential for such support, much less solicit it.

**LIKELY OPPOSITION:** We are unaware of any specific segments that might oppose this Proposal but anticipate that there could be such opposition from attorneys representing plaintiffs. It is also possible that certain interest that have historically opposed unlawful discrimination may oppose this Proposal, although the efficacy of such opposition may be diluted if it fails to acknowledge that some forms of discrimination are lawful and may serve salutary purposes in the case of certain nonprofit organizations.

**FISCAL IMPACT:** None.

**GERMANENESS:** The matters addressed in this Proposal require the special knowledge, training, experience or technical expertise of the Section and of members of the Committee. The position advanced would promote clarity, consistency and comprehensiveness in the law. Adoption of the Proposal would thus promote more efficient use of the judicial system.

### **TEXT OF PROPOSAL**

#### **SECTION 1. Section 5047.1 of the Corporation Code is amended to read:**

(a) The Legislature finds and declares that the services of directors and officers of nonprofit corporations who serve without compensation are critical to the efficient conduct and management of the public service and charitable affairs of the people of California. The willingness of volunteers to offer their services has been deterred by a perception that their

personal assets are at risk for these activities. The unavailability and unaffordability of appropriate liability insurance makes it difficult for these corporations to protect the personal assets of their volunteer decisionmakers with adequate insurance. It is the public policy of this state to provide incentive and protection to the individuals who perform these important functions.

(b) Except as provided in this section, no cause of action for monetary damages shall arise against any person serving without compensation as a director or officer of a nonprofit corporation subject to Part 2 (commencing with Section 5110), Part 3 (commencing with Section 7110), or Part 4 (commencing with Section 9110) of this division on account of any negligent act or omission occurring (1) within the scope of that person's duties as a director acting as a board member, or within the scope of that person's duties as an officer acting in an official capacity; (2) in good faith; (3) in a manner that the person believes to be in the best interest of the corporation; and (4) is in the exercise of his or her policymaking judgment.

(c) This section shall not limit the liability of a director or officer for any of the following:

(1) Self-dealing transactions, as described in Sections 5233 and 9243.

(2) Conflicts of interest, as described in Section 7233.

(3) Actions described in Sections 5237, 7236, and 9245.

(4) In the case of a charitable trust, an action or proceeding against a trustee brought by a beneficiary of that trust.

(5) Any action or proceeding brought by the Attorney General.

(6) Intentional, wanton, or reckless acts, gross negligence, or an action based on fraud, oppression, or malice.

(7) Any action brought under Chapter 2 (commencing with Section 16700) of Part 2 of Division 7 of the Business and Professions Code.

(8) *Knowing and intentional misconduct by the director or officer causing, or intended by the director or officer to cause, the unlawful restriction of membership, services or benefits conferred on the basis of political affiliation, age, or any characteristic listed or defined in subdivision (b) or (e) of Section 51 of the Civil Code.*

(d) This section only applies to nonprofit corporations organized to provide religious, charitable, literary, educational, scientific, social, or other forms of public service that are exempt from federal income taxation under Section 501(c)(3) or 501(c)(6) of the Internal Revenue Code.

(e) This section applies only if the nonprofit corporation maintains a ~~general~~ liability insurance policy with an amount of coverage of at least the following amounts:

(1) If the corporation's annual budget is less than fifty thousand dollars (\$50,000), the minimum required amount is five hundred thousand dollars (\$500,000).

(2) If the corporation's annual budget equals or exceeds fifty thousand dollars (\$50,000), the minimum required amount is one million dollars (\$1,000,000).

This section applies only if ~~the~~ a claim for the injury asserted against the director or officer ~~may~~ can also be made directly against the corporation and a ~~general~~ liability insurance policy is in force both at the time of injury and at the time the claim against the corporation is made, so that a policy is applicable to the claim. If a ~~general liability~~ *such* policy is found to cover the damages caused by the director or officer, no cause of action as provided in this section shall be maintained against the director or officer.

(f) For the purposes of this section, the payment of actual expenses incurred in attending meetings or otherwise in the execution of the duties of a director or officer shall not constitute compensation.

(g) Nothing in this section shall be construed to limit the liability of a nonprofit corporation for any negligent act or omission of a director, officer, employee, agent, or servant occurring within the scope of his or her duties.

~~(h) This section does not apply to any corporation that unlawfully restricts membership, services, or benefits conferred on the basis of race, religious creed, color, national origin, ancestry, sex, marital status, disability, political affiliation, or age.~~ This section does not apply to any volunteer director or officer who receives compensation from the corporation in any other capacity, including, but not limited to, as an employee.

SEC. 2. Section 24001.5 of the Corporations Code is amended to read:

24001.5. (a) The Legislature finds and declares that the services of directors or officers of nonprofit medical associations, as defined in Section 21200, who serve without compensation are critical to the efficient conduct and management of the public service and charitable affairs of the people of California. The willingness of volunteers to offer their services has been deterred by a perception that their personal assets are at risk for these activities. The unavailability and unaffordability of appropriate liability insurance makes it difficult for these associations to protect the personal assets of their volunteer decisionmakers with adequate insurance. It is the public policy of this state to provide incentive and protection to the individuals who perform these important functions.

(b) Except as provided in this section, no cause of action for monetary damages shall arise against any person serving without compensation as a director or officer of a nonprofit medical association, as defined in Section 21200, on account of any negligent act or omission occurring (1) within the scope of that person's duties as a director acting as a board member, or within the scope of that person's duties as an officer acting in an official capacity; (2) in good faith; (3) in a manner that the person believes to be in the best interest of the association; and (4) is in the exercise of his or her policymaking judgment.

(c) This section shall not limit the liability of a director or officer for any of the following:

- (1) Self-dealing transactions, as described in Sections 5233 and 9243.
- (2) Conflicts of interest, as described in Section 7233.
- (3) Actions described in Sections 5237, 7236, and 9245.
- (4) In the case of a charitable trust, an action or proceeding against a trustee brought by a beneficiary of that trust.
- (5) Any action or proceeding brought by the Attorney General.
- (6) Intentional, wanton, or reckless acts, gross negligence, or an action based on fraud, oppression, or malice.
- (7) Any action brought under Chapter 2 (commencing with Section 16700) of Part 2 of Division 7 of the Business and Professions Code.
- (8) *Knowing and intentional misconduct by the director or officer causing, or intended by the director or officer to cause, the unlawful restriction of membership, services or benefits conferred on the basis of political affiliation, age, or any characteristic listed or defined in subdivision (b) or (e) of Section 51 of the Civil Code.*

(d) This section only applies to nonprofit organizations organized to provide charitable, educational, scientific, social, or other forms of public service that are exempt from federal income taxation under Section 501(c)(3) or 501(c)(6) of the Internal Revenue Code.

(e) This section applies only if the nonprofit association maintains a ~~general~~ liability insurance policy with an amount of coverage of at least the following amounts:

(1) If the association's annual budget is less than fifty thousand dollars (\$50,000), the minimum required amount is five hundred thousand dollars (\$500,000).

(2) If the association's annual budget equals or exceeds fifty thousand dollars (\$50,000), the minimum required amount is one million dollars (\$1,000,000).

This section applies only if the ~~general~~ liability insurance policy ~~is in force both at the time of injury and at the time that the claim is made, so that the policy is applicable to the claim.~~

(f) For the purposes of this section, the payment of actual expenses incurred in attending meetings or otherwise in the execution of the duties of a director or officer shall not constitute compensation.

(g) Nothing in this section shall be construed to limit the liability of a nonprofit association for any negligent act or omission of a director, officer employee, agent, or servant occurring within the scope of his or her duties.

~~(h) This section does not apply to any association that unlawfully restricts membership, services, or benefits conferred on the basis of race, religious creed, color, national origin, ancestry, sex, marital status, disability, political affiliation, or age.~~

~~(ih)~~ This section does not apply to any volunteer director or officer who receives compensation from the association in any other capacity, including, but not limited to, as an employee.